United States Court of Appeals

for the Second Circuit

PETITION FOR REHEARING EN BANC

76-7258

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IRVING MASON, on behalf of himself and all others similarly situated, and derivatively on behalf of C.I. REALTY INVESTORS,

Appellant

BP/S

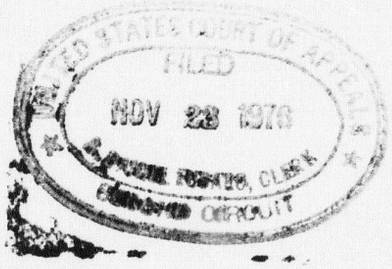
v.

CITY INVESTING COMPANY, C. I. REALTY INVESTORS, C.I. PLANNING CORPORATION, WILLIAM POLK CAREY, JOHN L. GIBBONS, PETER C.R. HUANG, JAMES V. TOMAI, JR., ROBERT M. MORGAN, WILLIAM S. RENCHARD, FRED R. SULLIVAN, JAMES R. WEBB and REYNOLDS SECURITIES INC.,

Appellees

On Appeal From The United States
District Court for the Southern
District of New York

PETITION FOR REHEARING
with suggestion of
REHEARING IN BANC



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PRELIMINARY STATEMENT

This appeal arises from an Order (dated May 3, 1976) by Judge Inzer B. Wyatt of the United States District Court for the Southern District of New York, dismissing two counts of appellant Irving Mason's complaint which alleged, inter alia, violations of Sections 10(b) and 14(a) of the Securities Exchange Act of 1934 (the "Exchange Act") derivatively on behalf of C.I. Realty Investors (the "Trust"). These derivative causes of action were dismissed for failure to make a demand on the shareholders of the Trust as required by Massachusetts law. After making an express determination that there is no just reason for delay, the Court entered a final judgment against appellant pursuant to Rule 54(b) of the Federal Rules of Civil Procedure, and this appeal followed on May 27, 1976 (App. 92a).

On November 9, 1976, a panel of this Court consisting of Honorables Paul R. Hays, Robert P. Anderson and William H. Timbers affirmed the decision of the District Court relying on Brody v. Chemical Bank, 482 F 2d 1111 (2nd Cir 1973).

Petitioner now requests rehearing and suggests that this is an appropriate case for consideration in banc.

REASONS FOR GRANTING THE PETITION

Petitioner respectfully presents the following reasons for granting the Petition for Rehearing:

1. If the panel decision should stand, it would be in direct conflict of the decision of the United States Supreme Court in J.I. Case v. Borak, 377 US 426 (1964)

2. The panel has misapprehended the import of Brody v. Chemical Bank, 482 F2d 1111 (2nd Cir 1973)

3. The panel has overlooked the expressed policy of this Circuit regarding impediments to shareholder derivative suits asserting violations of Federal Securities Laws.

STATEMENT OF THE CASE

In an April 13, 1972 public offering, C I Realty Investors raised approximately $ 65,000,000 by selling 2,600,000 Units of the Trust's securities to the public at $ 25.00 per Unit. Each Unit contained one share of beneficial interest in the Trust and one warrant to purchase an additional share at $ 25.00. On April 13, 1972, appellant Mason purchased 1,000 Units of the Trust for $ 25,000. The market value of each of the Trust's shares has since declined drastically, and they are presently trading at approximately $ 3.25 per share. The warrants are generally regarded as being worthless at this time.

On February 25, 1975 appellant Irving Mason (plaintiff below) filed a six count derivative and class action complaint in the United States District Court for the Eastern District of Pennsylvania alleging violations of various provisions of the federal securities laws, as well as pendent state law claims (App. 4a).

On March 20, 1975 Judge Newcomer of the Eastern District of Pennsylvania ordered this action transferred to the United States District Court for the Southern District of New York pursuant to 28 U.S.C. Section 1404(a).

The defendant C. I. Realty Investors is a Real Estate Investment Trust organized pursuant to Massachusetts law under a declaration of trust dated November 10, 1971, as amended on April 3, 1972 (App. 40a). The shares of the Trust are registered with the Securities and Exchange Commission pursuant to Section 12 of the Exchange Act. The Trust's shares have been traded on the over-the-counter market and, since December 12,

1973, on the New York Stock Exchange (App. 5a).

Various other defendants are also named in the complaint including , inter alia, the individual Trustees , and Reynolds Securities, Inc., an underwriter of the Trust's public offering of April 13, 1972.

Counts I, II and III of the Amended Complaint allege class action claims for violations by the defendants of Sections 10(b) and 13(a) of the Exchange Act and Rules 10b-5, 13a-1, 13a-11 and 13a-13 promulgated thereunder as well as Sections 12(2) and 17(a) of the Securities Act of 1933 ("Securities Act") in connection with the preparation of the registration statement and issuance of the prospectus for the public offering of the Trust's shares commencing April 13, 1972. Count VI alleges class action claims for violations of state law against all defendants except the Trust and Reynolds Securities, Inc. Counts I, II, III and VI are collectively referred to as the class action counts. Count IV alleges violations of Sections 10(b) and 14(a) of the Exchange Act and Rules 10b-5 and 14a-9 promulgated thereunder, derivatively on behalf of the Trust against all of the defendants except Reynolds Securities, Inc. Count V alleges violations of the state fraud, self-dealing, conflict of interest and breach of fiduciary duty laws derivatively on behalf of the Trust against all the defendants except Reynolds Securities, Inc. Counts IV and V are collectively referred to as the derivative counts.

On May 3, 1976, the District Court entered an order which stayed the class action claims until there was a final determination of the related case of Steinberg v. Carey and

dismissed the derivative counts solely on the grounds that plaintiff failed to make a demand upon the shareholders of the Trust as required by Massachusetts law. The Court further entered a final judgment in favor of defendants as to the derivative counts pursuant to Rule 54(b) of the Federal Rules of Civil Procedure (App. 92a).

ARGUMENT

I. The panel decision is in direct conflict with the decision of the United States Supreme Court in J.I. Case v. Borak, 377 US 426 (1964)

The Court here requires a derivative plaintiff to make demand upon the shareholders prior to instituting suit in federal court to redress violations of federal securities laws. By imposing a burdensome and futile state procedural requirement as a prerequisite to this suit, the decision conflicts with J.I. Case v. Borak, 377 US 426, 434-35 (1964). The Supreme Court there discussed the relationship of state corporation law vis a vis federally protected rights:

> (W)e believe that the overriding federal law applicable here would, where the facts required, control the appropriateness of the redress despite the provisions of state corporation law, for it "is not uncommon for federal courts to fashion federal law where federal rights are concerned."
>
> * * *
>
> And if the law of the State happened to attach no responsibility to the use of misleading proxy statements, the whole purpose of the section might be frustrated. Furthermore, the hurdles that the victim might face (such as separate suits, as contemplated by Dann v. Studebaker-Packard Corp., supra, security for expenses statutes, bringing in all parties necessary for complete relief, etc.) might well prove insuperable to effective relief. (emphasis added)

Here there can be no doubt that the shareholder demand requirement will "prove insuperable" to a derivative suit to redress violations of the federal securities laws. See also Jannes v. Microwave Communications, 57 F R D 18 (ND Ill 1972); Dopp v. American Electronics, 55 F R D 151 (SDNY 1972).

2. The panel decision misapprehends the import of Brody v. Chemical Bank, 482 F 2d 1111 (2d Cir 1973).

In the instant appeal the panel affirmed the District Court decision relying on Brody v. Chemical Bank, supra. However, plaintiff respectfully submits that reliance was misplaced. Though it is true that the Court in Brody states "it is settled that the federal courts will look to the state law in such cases to determine whether a demand on stockholders is necessary" 482 F2d at 1114, the decision cites two cases for this proposition: Gottesman v. General Motors, 268 F 2d 194 (2d Cir 1959) and Dopp v. American Electronics, 55 F R D 151 (SDNY 1972).

Looking at the result reached in Brody and the precedent relied on by that Court, it is apparent that the above language, relied on by the panel in affirming here, must be read in the context of the factual situation of Brody and the reasoning provided in Gottesman and Dopp. Plaintiffs contend that had the Brody court faced a circumstance where state law precluded suit without shareholder demand, it would not have spoken as it did but rather relied on the same precedent (i.e. Gottesman and Dopp) to hold, as plaintiffs suggest, that the state corporation law cannot require a derivative plaintiff to make a burdensome and futile demand on shareholders before instituting suit alleging federal securities law violations. See Gottesman, supra at 197; Dopp, supra at 155.

3. The panel decision overlooks the express policy of this Circuit regarding impediments to shareholder suits asserting violations of federal securities laws.

The decision in Brody refused to require a demand on shareholders be made by a derivative plaintiff. In so holding, the Brody court followed the policy earlier expressed in this Circuit that such a demand is both unnecessary and futile. Brody relied on the rationale of two earlier cases decided in this circuit for its decision Gottesman v. General Motors, 268 F2d 194 (2d Cir 1959) and Dopp v. American Electronics, 55 F R D 151 (S D N Y 1972). Since Brody was a per curiam decision it is clear there that the Court adopted not merely the specific holdings of these cases but also the rationale and policy decisions expressed in and relied on by the courts in this Circuit prior to the date of Brody.

This rationale and policy is most succinctly stated by quoting from the earlier decisions themselves. In Gottesman the Court's concern on the question of shareholder demand is evidenced by the strong language of the Court:

> As the issue now stands, there is no "substantial ground for a difference of opinion" as to the district court's refusal to require plaintiffs to make a demand on General Motors' shareholders. One need not be made where it is "not reasonable to require it", Hawes v. City of Oakland, 104 U S 450, 461 26 Led. 827, or where it "would be 'futile', 'useless' or 'unavailing'." Cathedral Estates v. Taft Realty Corp., 2 Cir., 228 F 2d 85,88.
>
> * * *
>
> (D)efendants petition here is predicated on a fundamental misconception of the role of the shareholders as a body with

> respect to derivative suits. A shareholder's vote cannot prevent the institution of a derivative suit or annual one once it has been brought; had that been possible it is obvious that very few such suits could or would have been maintained.
>
> * * *
>
> In the instant case. . .the wrongful acts alleged-violations of the antitrust laws by DuPont - can in no way be ratified or rectified by a vote of the shareholders of General Motors.
>
> 268 F2d at 197

The language of this Circuit above is clear and unequivocal. Indeed the Third Circuit in Rodgers v. American Can Co., 305 F 2d 297 (3rd Circuit 1962), perhaps the most exhaustive analysis of the question presented on this appeal, heavily relied on Gottesman in holding that even though shareholders had refused to authorize a law suit, such action could not estop a derivative plaintiff in his attempt to correct violations of federal law. Rodgers, supra at 314-15

In the other opinion cited by the Brody court, Dopp v. American Electric Laboratories, Inc., 55 F R D 151 (S.D.N.Y. 1972) the Court there too held that shareholder demand is not required as a prerequisite to a derivative action alleging violation of federal securities laws:

> As to plaintiff's failure to allege any reason for his failure to make a demand upon the shareholder, Rule 23.1 requires such demand only 'if necessary'. No such demand is required where, as here, the shareholders could not ratify the alleged wrongs since they constituted violations of federal law, and since the law of Delaware, the state of Butler's incorporation, does not require such a demand, at least in cases where illegality or fraud is alleged. 55 FRD at 154-44 (footnotes omitted).

In its citation to Dopp, the Brody court took time to specifically refer to footnote 10 of the Dopp opinion. That this footnote was significant to the Brody court, further supports the proposition that the Brody court adopted the rationale embodied therein:

> . . . On federal causes of action, federal courts will also look to the applicable state law to determine whether such a demand is necessary, see Gottesman v. General Motors Corp. 268 F 2d 194, 197 (2d Cir 1959), unless the state law frustrates the purposes of the federal statute. Cp. Levitt v. Johnson, 334 F2d 815 (1st Cir 1964), cert. denied 379 US 961, 85 S. Ct. 649, 13 L ed 2d 556 (1965). Here the Delaware rule is consistent with the broadly remedial purposes of the federal securities laws by eliminating what could be an onerous prerequisite to suit. Dopp, supra 55 F R D at 155 n.10 (emphasis added)

Clearly had the state law under consideration in Brody mandated the "onerous prerequisite" of shareholder demand, the Brody court, with the support of the earlier policy decisions of this Circuit, would have found that such "state law frustrates the purposes of the federal statute."

Plaintiff respectfully submits that had the panel in the instant appeal so held the decision would have been consistent with Brody, Gottesman and Dopp; and that its failure to so hold is, in fact, inconsistent with the previous decisions of this Grcuit.

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REYNOLDS SECURITIES, INC.,

Appellees

On Appeal From the United States District Court for the Southern District of New York

SUGGESTION FOR REHEARING IN BANC

Petitioner respectfully suggests that this is an appropriate case for consideration by the full court because:

1. In banc consideration is necessary to maintain uniformity among its decisions.

The panel decision, which affirming on the basis of Brody v. Chemical Bank, 482 F2d 1111 (2nd Cir 1973), reaches a result neither anticipated nor warranted by that opinion or its precedent. In fact, the result of the decision of the panel is in direct opposition to the reasoning and spirit of Gottesman v. General Motors, 268 F2d 194 (2nd Cir 1959) and Dopp v. American Electronic, 55 FRD 151 (S D N Y 1972), the cases relied on by the Court in deciding Brody v. Chemical Bank, supra.

Therefore, there now exists a dichotomy among the decisions of the Circuit. Gottesman v. General Motors, supra specifically held that" shareholders cannot prevent the institution of a derivative suit or annul one once it has been brought" 268 F2d at 197. Thus, Gottesman is in accord with the decisions of the First Circuit's Levitt v. Johnson, 344 F2d 815 (1st Cir. 1964) (which includes the state of Massachusetts) and the Third Circuit Rodgers v. American Can, 305 F 2d 297 (3rd Cir 1962).

Nowhere in the per curiam opinion Brody v. Chemical Bank, supra, does the Court give any indication of its desire to impose upon a derivative plaintiff the futile task of making a shareholder demand as a prerequisite to federal securities litigation. Finally, the panel decision, if permitted to stand, will allow state law to frustrate the purposes of the federal securities statutes. Such a result is in conflict with the previous cases decided in this circuit. See Brody, supra at 1114; Gottesman, supra at 197; Dopp, supra at 155 n.10. See discussion infra at pp. 8 - 10.

2. This appeal involves a question of exceptional importance requiring consideration in banc.

The panel decision affirmed relying on a per curiam decision in Brody. Yet Brody was a decision whose result was consistent with the prevailing policy of permitting federal securities litigation to proceed without regard to state procedural impediments. J. I. Case v. Borak, 377 U S 426 (1964) . Petitioner respectfully submits that had Brody been confronted with a state statute requiring shareholder demand, the panel would not have required such.

In any event, the importance of a decision which severely limits the plaintiff's right to assert violations of federal securities law should only be made after an extensive analysis of the legal and public policy issues raised. See Levitt v. Johnson, supra; Rodgers v. American Can, supra . Petitioner suggests that the opinion in Brody did not do so because the result of denying access to federal forum was not anticipated. The facts in the instant case demand a thorough analysis of the underlying policy decisions of the holdings of J.I. Case v. Borak, 377 U S 426 (1964), Brody and Gottesman. Petitioner respectfully suggests that a decision which operates to deny a derivative plaintiff the right to assert a federal law violation on the basis of state statute is of such exceptional importance as to require in banc consideration.

CONCLUSION

On the basis of the foregoing, petitioner respectfully requests this Honorable Court to grant rehearing in this matter. Further, petitioner believes that this appeal raises an issue of exceptioned importance requiring in banc consideration.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that the foregoing Petition For Rehearing with suggestion of Rehearing In Banc was served by first class mail, postage pre-paid upon Richard Nolan, Esq., Davis, Polk & Wardwell, One Chase Manhattan Plaza, New York, New York 10005 on November 23, 1976.

Philip Stephen Fuoco

Dated: November 23, 1976